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SUBJECT: UAE STOCK MARKET DOWN

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11. (U) Summary: The UAE's two stock markets, like others in the region, are experiencing a sharp drop from the high prices of 2005. GCC investors, especially Saudis, are reportedly withdrawing from the UAE market and investors are nervous about increasing Iranian-U.S. tensions. The U.S. stock market may be the beneficiary of the drop in GCC stock markets as investors again look to move their financial assets outside the region. UAE investors are highly leveraged. Falling stock markets are forcing them to sell their shares in order to meet their loan payments, further driving down prices. So far, the UAE federal and emirate-level governments are not intervening aggressively to prop up the market, although they are looking at some steps to improve investor confidence. Fundamentally, however, it does not appear that the current bear market will have a systemic effect on the UAE economy, although it may hurt individual companies and investors. Other economic indicators remain strong, oil prices are high, and the Emirate of Abu Dhabi has sufficient reserves available to cushion any major economic impact on UAE nationals. End Summary.

The Bubble Has Burst

12. (U) In 2005, the UAE's two local stock markets grew explosively, when they led the region in terms of market capitalization, turnover, and number of IPOs. By the end of 2005, both the Dubai Financial Market and the Abu Dhabi stock market were overvalued. In early 2006, two large simultaneous IPOs pulled liquidity out of the market and helped trigger a significant, ongoing correction (reftel). As of May 7, both the Dubai Financial Market index and the Abu Dhabi Stock Market index reached their lowest levels in 14 months. According to newspaper reports, total market capitalization dropped about 20% from October 2005 (around \$221 billion) to \$175 billion on May 7, 2006. Most financial advisors and investors argue that the UAE stock markets are either becoming reasonable again or are undervalued. Several noted that blue chip stocks like property developer Emaar and telecommunications company Etisalat were extremely cheap, as were several financial institutions.

13. (U) Although the market bubble was bound to pop, there are concerns that it is overshooting on the way down. There are several reasons for the continued drop. Very few companies on either stock market are actively traded, a factor which increases volatility. Regional investors, who invested heavily in the UAE's market in 2005, have been reducing their exposure. One institutional investor noted that the Saudis triggered much of the latest stock market drop when they sold their UAE securities to cover losses in the Riyadh stock market.

14. (U) Market psychology certainly is playing a role, as investors express concerns about Iranian-Western tensions, a lack of transparency in the market, and general fears that the markets will keep going down. One financial advisor told econchief that although he thought the market was fundamentally undervalued, he wouldn't recommend investing in it until it stabilized.

15. (U) Leverage (i.e, borrowing) and "stop loss" orders for sales are the major driving force behind the current drop. There are five large mutual funds in the UAE offering both UAE nationals and expatriates an easy way to invest in UAE stock markets. All of these funds encouraged investors to leverage their positions, and UAE banks have also increased their loans to stock market participants. During the boom market, investors were able to repay their short-term loans. Now that the market is dropping, however, investors are forced to sell their shares in order to repay these loans. In addition, many investors - including the institutional investors have "stop loss" orders instructing their brokers to sell shares when they drop below a certain price. The current drop in price has triggered these orders, further pushing prices downward.

What is the Government doing?

16. (U) There are increasing public calls for the government to act to help stabilize the market, and some limited

government action is already occurring. The Emirate of Abu Dhabi has reportedly authorized its pension fund to invest two billion dirhams in the Abu Dhabi stock market over the next two to three months. One analyst argued that the UAEG would not intervene in the market sufficiently. He noted that the federal government didn't have the financial resources to intervene aggressively in either market, and that the Emirate of Abu Dhabi is unlikely to intervene to prop up Dubai's market. For its part, the Dubai government is heavily invested in real estate projects and may not have the funds readily available to intervene in the stock market.

17. (U) The UAEG is looking at other steps to improve regulations and investor confidence. The cabinet is considering a Ministry of Economy proposal that would facilitate company buy-backs of outstanding shares. The Ministry of Economy has also taken steps to better regulate the schedule of IPOs or new capital increases in order to ensure that they do not draw liquidity from the market. Some investors, however, are arguing that the intervention is "too little, too late" and are clamoring for more aggressive moves, including having the banks reschedule loans so that investors do not need to liquidate their holdings to meet repayment deadlines.

18. (U) There has also been a call for improving transparency and regulations in the markets. The semi-official Arabic daily Al-Ittihad published an editorial by the Emirates Center for Strategic Studies and Research calling for increased authority for regulators to deal with problems of transparency and situations where some investors have access to information in advance of others (i.e., insider trading).

19. (U) UAE stock markets are still relatively immature and have been developing much faster than regulatory capability. Hence, there are problems with transparency and governance. Several financial analysts have privately noted, however, that "no one complained when the market was going up," and that regulations tend to tighten in market downturns. They add that generally enough information is available on the major companies for investors to be able to make investment decisions. One Abu Dhabi investor admitted that it was harder for him to assess the Dubai market, with its extensive government ownership and cross holding of shares. Even there, he argued, information on companies such as National Bank of Dubai was adequate for analysis. The UAEG has taken some steps to deal with the perception of transparency, with the Securities and Commodities Authority announcing that it would fine listed companies that failed to disclose their first quarter results on time.

Where is the Money Going?

10. (U) High oil prices ensure that the UAE remains flush with cash, although it is not going into the stock market. One financial analyst noted that individuals are keeping their funds in deposit accounts for the time being. Several analysts stated that the U.S. stock market was the major beneficiary of the fall in GCC stock markets. They argued that post 9/11, many Gulf Arabs increased their regional investments and reduced their U.S. exposure. With regional tensions and falling regional equity markets, they are again looking overseas. This means, they note, that the U.S., with the world's largest and most transparent capital markets, is benefiting. They cite recent increases in the U.S. markets to prove their contention.

What does the Market's Fall Mean to the Economy?

11. (U) The local papers are full of articles discussing the importance of a stock market to a country's economy, and some are justifying government intervention on economic grounds. It doesn't yet appear, however, that the markets' fall will have a systemic impact on the UAE's economy. Oil prices are projected to remain high and massive investment projects, especially in Abu Dhabi and Dubai, will continue to support economic growth. This doesn't mean, however, that some companies and investors won't be affected.

12. (U) The banking sector's profitability has been largely due to its involvement in IPOs and equity markets, through fees and margin lending. The insurance sector has invested heavily in the UAE stock markets on its own account. Individual investors are facing dropping stock market prices and loan repayments. In addition, some analysts have warned that the drop in the stock market could have an impact on the overheated Dubai property market as investors either sell off their property or (more likely?) don't invest as heavily in new developments. In any case, the Government of Abu Dhabi is likely to have sufficient financial resources to cushion any major UAE-wide or Abu Dhabi specific economic impact on UAE nationals.

Whither the Market?

113. (U) There is much speculation regarding where the UAE market is going over the next few months. It is now getting cheap enough to attract investors put off by the high prices of 2005. Some analysts suggest that quasi-institutional investors will eventually step in or companies will buy their shares back. Others, especially those calling for government intervention argue that UAE investors may be losing trust in the market and are not likely to jump back in quickly. They note that UAE stocks took years to recover from the last collapse in the "over the counter" market in the late '90s and suggest that recovery could be prolonged in this case as well. No one is expecting a rapid growth in the market like that seen in 2005.

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